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91-877

No. 91-

In The

Supreme Court of the United States

October Term, 1991

Ernst & Young,
Petitioner,

v.

Bob Reves, et al.,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. In a private action for damages under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), whether this Court's decision in *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972), entitles a plaintiff class of securities purchasers to a presumption of reliance on a defendant's factual omissions, even though plaintiffs never alleged that they received the financial statements or heard the oral presentations in which the omissions were made or that they otherwise relied on any conduct of the defendant in making their investment decisions.

2. Whether, in holding petitioner liable under Section 106(c) of the Arkansas Securities Act, Ark. Stat. Ann. § 23-42-106(c), under a theory of liability that was necessarily based on factual findings never made by the district court, never presented to the jury, and not otherwise supported by the record, the court of appeals so far departed from the accepted rules of appellate review as to call for the invocation of this Court's supervisory powers.

PARTIES TO THE PROCEEDING

In addition to the parties listed in the caption, in the proceedings below Frances Graham was a plaintiff/appellee and plaintiff/cross-appellant. Robert H. Gibbs appeared individually as a plaintiff/appellee, and he appeared as a plaintiff/cross-appellant in three separate capacities: (i) individually, (ii) as natural guardian of his minor children, Thomas A. Gibbs and Robert H. Gibbs, Jr., and (iii) as Trustee of the Muskogee Internal Medicine Group Profit Sharing Funds. Thomas E. Robertson, Jr., as trustee of the Farmer's Co-op of Arkansas and Oklahoma, Inc., and as representative of a class of members, depositors, and equity security holders, appeared as a plaintiff/appellee and plaintiff/cross-appellant; and Robert R. Cloar, Class Counsel, was an appellant.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-69a) is reported at 937 F.2d 1310. The pre-trial opinion of the district court (Pet. App. 70a-121a) considering various defendants' motions to dismiss is reported at 633 F. Supp. 954. The pre-trial opinion of the district court (Pet. App. 122a-229a) granting in part and denying in part petitioner's motion for summary judgment is unreported. The post-trial opinion of the district court (Pet. App. 232a-292a) denying petitioner's motion for judgment notwithstanding the verdict is unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 27, 1991 (Pet. App. 4a), and a timely petition for rehearing was denied on August 29, 1991 (Pet. App. 303a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254.

STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, and Section 106 of the Arkansas Securities Act, Ark. Stat. Ann. § 23-42-106,[1] are reproduced at Pet. App. 304a-306a.

STATEMENT

1. *The Co-op And Its Demand Note Program.* This case arises out of the 1984 bankruptcy of the Farmer's Cooperative of Arkansas and Oklahoma, Inc. ("Co-op"). The Co-op was organized in 1946 and was conducting extensive business operations in western Arkansas and eastern Oklahoma by the late 1970's. Beginning in 1959, the Co-op raised capital to support its general business operations by selling promissory notes payable on demand of the holder. These demand notes were uncollateralized and

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[1] At the time this case was tried, this section was codified as Ark. Stat. Ann. § 67-1256.

uninsured, but were attractive to investors because they paid a higher rate of interest than the rates offered by local financial institutions. Pet. App. 7a. The Co-op advertised the demand note program in its monthly newsletter. The advertisement stated that "YOUR CO-OP has more than $11,000,000 in assets to stand behind your investments. The Investment is not Federal [sic] insured but it is * * * Safe * * * Secure * * * and available when you need it." C.A. Jt. App. 1820 (ellipses in original).

2. *Arthur Young's Audits.* Arthur Young & Company was first retained as the Co-op's independent auditor in 1981.[2] It subsequently issued audit reports on the Co-op's financial statements for the years ending December 31, 1981 and December 31, 1982. Upon assuming its duties as the Co-op's auditor, Arthur Young was required to address a number of accounting issues. One major issue was evaluating the carrying value of a gasohol plant that was owned by the Co-op through its wholly-owned subsidiary, White Flame Fuels, Inc. ("White Flame").

In 1979, the Co-op's general manager, Jack White, had joined with another individual to finance and construct the gasohol plant. Beginning in January 1980, White obtained loans from the Co-op to finance the continued construction and the initial operation of the gasohol plant. White personally guaranteed these loans. The plant began producing gasohol in April 1980, but was soon beset by problems stemming from its poor design and from economic factors such as the falling price of oil. White continued to obtain loans from the Co-op to cover the plant's operating costs. By December 1980, the loans totalled approximately $4 million. Eventually, the Co-op's board of directors voted to purchase all of the stock of White Flame in exchange for the Co-op's assumption of White's $4 million debt. Pet. App. 7a-9a.

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[2] In 1989, Arthur Young and Ernst & Whinney combined to form the firm of Ernst & Young, which is the petitioner in this case. Because the events at issue occurred prior to 1989, we will refer to petitioner as Arthur Young.

The proper accounting treatment for the gasohol plant depended on whether the Co-op had owned the plant from the beginning of its construction. If so, the plant could be carried at historical cost, approximately $4.5 million net of depreciation. If not, the proper carrying value would have been the fair market value of the plant at the time of transfer, which subsequently was estimated to have been between $444,000 and $1.5 million. Pet. App. 14a & n.7. Although the stock of White Flame was originally owned by White and his partner, Arthur Young concluded that the Co-op's carrying the plant at its historical cost of $4.5 million would not violate generally accepted accounting principles ("GAAP") because the plant had been constructed primarily with funds borrowed from the Co-op. *Id.* at 12a-15a, 20a. Because the Co-op's balance sheets for 1981 and 1982 reflected a net worth of only $2.6 million and $1.3 million, respectively, carrying the plant at its fair market value instead of historical cost would have resulted in the Co-op's balance sheets showing a negative net worth. *Id.* at 15a, 20a.

Although Arthur Young concluded that carrying the gasohol plant at its historical cost would not violate GAAP, it also concluded, because of uncertainty over the recoverability of the cost of the plant, that it could not express an opinion on whether carrying the plant at historical cost fairly presented the financial condition of the Co-op. Arthur Young therefore issued qualified opinions on both the 1981 and 1982 financial statements. The 1981 audit report stated that:

> As discussed in Note 9 to the consolidated financial statements, there is some doubt as to the recoverability of the investment in the gasohol plant of White Flame Fuels, Inc. and its continuing operations. Management has not prepared projections and other analyses to assess the potential recovery of this investment. Accordingly, we are unable to satisfy ourselves as to the appropriate carrying value of such amounts as presented in the accompanying consolidated financial statements.

C.A. Jt. App. 235; Pet. App. 14a.

Footnote 9 to the Co-op's financial statements addressed the accounting for the gasohol plant and the economic prospects of the Co-op:

> Financing of the initial construction and subsequent revisions which totaled approximately $4,522,000, was provided by the Co-op. Also, from the initial start of production through December 31, 1981, the Co-op has provided operating capital for White Flame. As of December 31, 1981, the Co-op had an investment of approximately $5,830,000 in White Flame. The ability of the Co-op to continue providing funds to cover operating losses of White Flame Fuels, Inc. (currently averaging $100,000 per month) until such time that improvements in market conditions and production efficiency permit profitable operations are not determinable. The combination of factors as mentioned above, which must result favorably, cast doubt on the recovery by the Co-op of its investment in White Flame Fuels, Inc. and the recovery by White Flame Fuels, Inc. of its investment in plant and equipment on the basis of a going concern. Projections and other analyses have not been prepared by management in order to assess the potential recoverability of this investment.

C.A. Jt. App. 251-252; Pet. App. 15a.[3]

The audited financial statements also revealed other negative information concerning the Co-op's financial condition. In particular, they indicated that the Co-op's current liabilities were approximately double its current assets and that the Co-op had suffered net losses of $1.4 million in 1981 and $1.2 million in 1982. C.A. Jt. App. 238-240, 261-263. Since 1955, the Co-op had suffered a net loss on only one previous occasion—a loss of $138,536 in 1967. *Id.* at 231. Arthur Young presented its audit

[3] Arthur Young's audit report on the Co-op's 1982 financial statement contained the same qualification as its 1981 report, and the 1982 financial statements themselves, in footnote 8, provided updated information on White Flame's worsening financial condition and the resulting uncertainty about the Co-op's ability to recover its investment. C.A. Jt. App. 258, 272-273; Pet. App. 19a-20a.

reports to the Co-op's board, but there is no evidence that the Co-op ever distributed the audit reports or audited financial statements to Co-op members or note holders.

3. *The 1982 and 1983 Annual Meetings And Condensed Financial Statements.* In addition to issuing the audit reports, representatives of Arthur Young gave oral presentations on the financial condition of the Co-op at its annual meetings in May 1982 and March 1983. At these meetings, condensed financial statements prepared by the Co-op were distributed to the audience. At the beginning of their oral presentations, Arthur Young's representatives informed the members of the audience that they had received only condensed financial statements and that copies of the full audited statements were available at the Co-op's offices. Pet. App. 17a, 21a. The record does not indicate that anyone ever asked to see the audited financial statements. The condensed financial statements did not include the qualifications in Arthur Young's audit reports or the footnote disclosures concerning the gasohol plant. *Id.* at 16a, 21a.

The condensed statement of operations handed out at the 1982 meeting did not incorporate the gasohol plant operations and therefore reflected a net profit of $154,000. C.A. Jt. App. 231. The condensed balance sheet included the gasohol plant valued at historical cost and therefore reflected net members' equity of $2.6 million. Pet. App. 16a. During the course of the oral presentation by Arthur Young's representative, the audience soon began asking questions concerning White Flame and its financial status. During these interchanges, White Flame's $1.2 million dollar loss in 1981 was disclosed to the audience. The meeting became very heated, with the audience asking many questions about White Flame and other items in the condensed financial statements. As the questions increased in both frequency and intensity, Arthur Young's representative was unable to respond and the Co-op's board moved the meeting on to the next item on the agenda. *Id.* at 17a.

At the 1983 annual meeting, the Co-op distributed condensed financial statements that more completely presented the Co-op's rapidly worsening financial condition. However, they again did not contain the qualification in Arthur Young's audit opinion or the footnote disclosure on the gasohol plant. Pet. App. 20a. The condensed statement of operations for the 1983 annual meeting did include the gasohol plant and reflected losses of $1.4 million in 1981 and $1.2 million in 1982. C.A. Jt. App. 233. In addition, the balance sheet reflected current assets of only $6.9 million to cover current liabilities of $15.3 million. *Id.* Net members' equity had dropped from $2.6 million to $1.3 million. *Id.* The oral presentation of Arthur Young's representative at the 1983 meeting lasted only about three minutes. Pet. App. 21a.

4. *The Co-op's Bankruptcy.* In addition to the demand notes, the Co-op relied on funding from the Cooperative Finance Association ("CFA"), which had provided loans and lines of credit to the Co-op. Because of the Co-op's reliance on demand notes, CFA had informed the Co-op that if the amount of invested notes dropped below $9.5 million, CFA would cut off the Co-op's line of credit. In February 1984, the aggregate demand notes dropped slightly below $9.5 million, and CFA refused to advance additional funds on the line of credit. On February 23, 1984, the Co-op filed for bankruptcy. Pet. App. 21a-22a.

5. *The Proceedings Below.* Less than a year later, the Co-op's bankruptcy trustee filed an action in the United States District Court for the Western District of Arkansas on behalf of the Co-op and certain demand note holders against forty individuals and entities, including Jack White, members of the Co-op's board, several of the Co-op's lawyers, Arthur Young, and the two auditors that had preceded Arthur Young. The complaint alleged a wide variety of federal and state causes of action, including common law fraud, violations of the registration and disclosure provisions of the Arkansas Securities Act, violations of Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), and violation of the Racketeer

Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-68. Subsequently, the district court certified a class consisting of persons who purchased demand notes between February 15, 1980, and February 23, 1984, and named Bob Reves, Frances Graham, and Robert Gibbs as the class representatives. Pet. App. 23a.

Prior to trial, all defendants except Arthur Young and White's lawyers settled the claims against them. Pet. App. 23a.[4] In addition, the district court dismissed or granted Arthur Young summary judgment on all of the Class' claims against it other than the Section 10(b) claims and claims that Arthur Young was secondarily liable for disclosure violations of the Arkansas Securities Act. Arthur Young requested summary judgment on the Section 10(b) claims on the basis that "no one specifically relied on any of its representations concerning the financial status of the Co-op." Pet. App. 209a. Although the district court granted summary judgment to Arthur Young on the Class' common law fraud claims because the "record [did] not permit a finding of the specific kind of reliance required by the common law precedents in this state or others" (*id.* at 191a), the district court did not grant summary judgment on the Section 10(b) claims. While noting that "Rule 10b-5 at least arguably requires a showing of reliance missing from plaintiffs' proofs," the district court determined that it would reserve judgment on the issue until after trial. *Id.* at 215a.

After a month-long trial, the district court gave the following instruction to the jury on the issue of reliance:

> [I]n order to satisfy this element, the Class need not prove that the Class actually relied on defendant's conduct. Rather, plaintiff's [sic] can satisfy his burden if he proves that the defendant sought to be charged omitted to state a fact to him, and that the omitted fact was material.

Pet. App. 42a n.23.

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[4] White's lawyers settled after trial. Pet. App. 23a n.13.

The jury found that Arthur Young had committed primary violations of Section 10(b) and secondary violations of the Arkansas securities statute. Pet. App. 25a. The jury awarded damages of $6.1 million to members of the Class who purchased demand notes between April 22, 1982, the date Arthur Young submitted its first audit report to the Co-op's board, and February 23, 1984, the date the Co-op filed for bankruptcy. *Id.* at 56a. In its motion for judgment notwithstanding the verdict, Arthur Young reasserted its argument that there was no evidence that any member of the Class relied on any representation made by Arthur Young. *Id.* at 281a. The district court decided, however, that the Class was entitled to a presumption of reliance on factual omissions under this Court's decision in *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-154 (1972). Pet. App. 286a. With respect to secondary liability under the Arkansas Securities Act, the district court did not find that Arthur Young fell within any of the classes of persons enumerated in the statute as having secondary liability, but held that anyone who would have been liable as a joint tortfeasor at common law could also be secondarily liable under the Act. *Id.* at 270a-271a.

Both Arthur Young and the Class appealed the district court's judgment to the United States Court of Appeals for the Eighth Circuit. In its first opinion in this case, the court of appeals held that the demand notes were not securities under federal and Arkansas securities laws and reversed the district court's judgment. *Arthur Young & Co. v. Reves*, 856 F.2d 52 (1988). This Court granted certiorari and reversed the judgment of the Eighth Circuit, holding that the demand notes were securities under the 1934 Act. *Reves v. Ernst & Young*, 110 S. Ct. 945 (1990).

On remand, the court of appeals concluded the demand notes also were securities under Arkansas law and affirmed the district court's judgment that Arthur Young had committed primary violations of Section 10(b) and was secondarily liable for violations of the Arkansas

Securities Act. The Eighth Circuit reversed the district court's judgment, however, on the issues of damages, settlement credits, and attorneys' fees and remanded for further procedings on these issues. Pet. App. 69a.

Arthur Young's primary argument to the court of appeals was based on the failure of the Class to present any evidence that there had been any communication between Arthur Young and any member of the Class. Throughout the litigation, the Class tried to pass off statements made by Arthur Young's representatives at the Co-op's annual meetings as statements that had been made by Arthur Young *to the Class*. However, there is no evidence in the record that any of the class members ever (1) received the audited financial statements, or (2) attended one of the annual meetings. Conversely, there is no evidence that any individual who saw the audited financial statements or attended the annual meetings thereafter purchased demand notes. Because of this absence of any connection between anything the class members saw or heard and Arthur Young's conduct, Arthur Young argued that the Class members could not have relied on Arthur Young in purchasing the demand notes.

The court of appeals acknowledged Arthur Young's argument in passing (Pet. App. 41a), but nevertheless held that the Class was entitled to a presumption of reliaance under *Affiliated Ute*. Although "recogniz[ing] that there is some analytical difficulty in separating misrepresentations from nondisclosures" (Pet. App. 42a), the court of appeals agreed with the district court that the case involved primarily nondisclosures. In addition, the court found that Arthur Young owed the Class a duty to disclose under a seven-factor "flexible duty" test. *Id.* at 45a & n.26. However, none of the factors identified by the court of appeals encompassed consideration of the question whether there was any factual connection between the class members' investment decisions and Arthur Young's conduct. *Id.*

Although the Eighth Circuit also affirmed the district court's finding of secondary liability under Section 106(c)

of the Arkansas Securities Act, it disagreed with the district court's use of common law theories to reach that result, referring to them as "an amalgam of rather tenuous theories." Pet. App. 35a. Instead, the court of appeals found Arthur Young liable under Section 106(c) on the ground that it had materially aided in the sale of the securities. *Id.* at 34a. Although Section 106(c) explicitly limits the categories of persons who can be secondarily liable for materially aiding in the sale of a security to employees of the seller, broker-dealers, and agents (as defined in the statute), the Eighth Circuit did not, and apparently could not, specify within which, if any, of the statutory categories it considered Arthur Young to fall.[5]

REASONS FOR GRANTING THE PETITION

This case squarely presents the issue of whether reliance should remain a separate and essential element of all private actions for damages under Section 10(b). The Eighth Circuit held that the Class was entitled to a "presumption" of reliance even in the absence of an allegation that Class members had ever heard or saw anything that Arthur Young said or did prior to making their investment decisions. In so doing, the Eighth Circuit fundamentally misconstrued this Court's decision in *Affiliated Ute*. In that case, this Court neither dispensed with reliance as an essential element of a Section 10(b) action nor created a presumption of reliance in the absence of evidence indicating that it was logical to do so. Rather, the Court explicitly found that plaintiffs had relied on defendants when they sold their stock, and this finding was one of the essential circumstances that rendered positive proof of reliance on specific factual omissions unnecessary.

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[5] Although the Class had previously alleged that Arthur Young was a "control person" under the Act, the court of appeals did not rest its decision on that ground and in fact suggested otherwise. Pet. App. 34a. ("We note in passing that Arthur Young certainly did not direct the Co-op's operations.").

In granting a presumption of reliance even when there was no reason to believe that the Class had actually relied on Arthur Young, the Eighth Circuit adopted a position that directly conflicts with the congressional determination that reliance should be an essential element of the express rights of action under the 1934 Act. This Court should grant certiorari in order to affirm that *Affiliated Ute* was not intended to provide a means to circumvent this fundamental policy determination.

The Court also should grant review in order to address the court of appeals' unwarranted departure from accepted rules of appellate procedure in affirming the district court's judgment of liability under the Arkansas Securities Act. While the court of appeals rejected the district court's legal theories, it nevertheless found Arthur Young liable under a provision of the Act that would apply only if Arthur Young were an "employee" of the Co-op, a "broker-dealer," or an "agent," as defined in the Act. The factual findings necessary to support liability under any of these three categories were not made by the district court or presented to the jury, and such findings are not otherwise supported by the record. Consequently, the court of appeals' action sufficiently departed from accepted rules of appellate procedure that this Court should exercise its supervisory power over the federal judiciary and grant this petition in order to reverse or remand for further proceedings.

I. THE COURT SHOULD AFFIRM THAT SECURITIES PLAINTIFFS ARE NOT ENTITLED TO A PRESUMPTION OF RELIANCE ON A DEFENDANT'S OMISSIONS OF PARTICULAR FACTS WHEN THEY HAVE NOT ALLEGED RELIANCE ON ANY CONDUCT OF THE DEFENDANT IN MAKING THEIR INVESTMENT DECISIONS

The Court has held that reliance is an essential element of a private action for damages under Section 10(b). *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988). This holding was based in part on a congressional determination that under the express causes of action provided by

the 1934 Act "the burden is on the plaintiff to show the violation or the fact that the statement was false or misleading, *and that he relied thereon to his damage.*" S. Rep. No. 792, 73d Cong., 2d Sess. 13 (1934) (emphasis added). *See Basic*, 485 U.S. at 243 (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976), in which the Court quoted the above-referenced passage from the Senate Report on the 1934 Act). The importance of the reliance requirement was further emphasized by the Chairman of the House committee responsible for the 1934 Act: "[T]he bill as originally written was very much challenged on the ground that reliance was not required. This objection has been met." Statement of Rep. Rayburn, 78 Cong. Rec. 7701 (1934); *see also Basic*, 485 U.S. at 258 (White, J., dissenting) ("Congress thus anticipated meaningful proof of 'reliance' before civil recovery can be had under the Securities Exchange Act.").

Our primary contention in this case is that the court of appeals seriously misconstrued this Court's decision in *Affiliated Ute* when it granted a presumption of reliance to plaintiffs who had not alleged that they either saw Arthur Young's audit reports or attended the Co-op's annual meetings at which Arthur Young's representatives made oral presentations. Throughout the lower court proceedings, the Class has attempted to obscure this core issue by intimating that the persons who attended the annual meetings are the same persons to whom Arthur Young was held liable. In fact, however, the record demonstrates no such thing.

To bring the issue in this case into sharper relief, Arthur Young acknowledges that it would have been appropriate to presume reliance on its alleged omissions by anyone who attended the annual meetings. Arthur Young submits, however, that granting a presumption of reliance on factual omissions to those who have not alleged reliance on *any* conduct of the defendant stretches this Court's holding in *Affiliated Ute* far beyond reasonable bounds and directly conflicts with the congressional de-

termination that reliance should be an essential element of a plaintiff's burden of proof.

A. The Court In *Affiliated* Ute Made An Explicit Finding That Plaintiffs Had Relied On Defendants When They Sold Their Stock, And This Finding Was One Of The Essential Circumstances That Rendered Positive Proof Of Reliance On Omissions Of Particular Facts Unnecessary

The Court's opinion in *Affiliated Ute* clearly shows that the Court neither dispensed with reliance as an element of a Section 10(b) action nor granted a presumption of reliance in the absence of evidence affirmatively indicating that it was logical to do so. Rather, the Court made an explicit finding that the plaintiffs had relied on defendants when selling their securities, 406 U.S. at 152, and this finding was one of the circumstances that provided the context for the following passage:

> Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact.

406 U.S. at 153-154 (citations omitted).

Based on this passage, the court of appeals approved a jury instruction stating that the Class need not prove it actually relied on Arthur Young's conduct.[6] But this interpretation of *Affiliated Ute* can be supported only by reading the paragraph dispensing with "positive proof of reliance" in isolation. As discussed below, the immedi-

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[6] The Eighth Circuit is not alone in its view that the reliance requirement has been eliminated in nondisclosure cases under Section 10(b). *See* 5A A. Jacobs, *Litigation and Practice Under Rule 10b-5*, § 62 at 3-254 (2d ed. 1991 rev.) ("the Supreme Court and other tribunals no longer require the element of reliance in 10b-5 concealment cases").

ately preceding nine pages of the Court's opinion describe the factual context for the failure to disclose and compellingly demonstrate that plaintiffs had actually and directly relied on defendants' conduct. Only reliance on omissions of particular facts was presumed; reliance on the conduct of defendants was manifest in the context of how the factual omissions were made.

The plaintiffs in *Affiliated Ute* were members of an Indian tribe who had received shares of stock in a corporation ("UDC") holding tribal assets. In order to protect the Indian stockholders, who were unsophisticated investors, UDC had imposed a number of unusual conditions on sales of its stock. Indians desiring to sell their stock were required to give first-refusal rights to other Indians, and sales could be made to non-Indians only if no Indian accepted the offer. 406 U.S. at 137 & n.7. One of the defendants in *Affiliated Ute* was a bank retained by UDC to act as transfer agent for UDC stock. *Id.* at 145. Two other defendants were assistant managers of a branch of the bank located in an area where many of the Indian stockholders resided. *Id.* at 146. The bank, primarily through the two managers, handled the documents implementing the first-refusal procedure. *Id.* at 147. Moreover, the bank had acknowledged to UDC that it had a duty to see that the transfers were properly made and that it would be acting for the Indian stockholders. *Id.* at 152. The Court specifically noted that Indians who contemplated the sale of their shares were "*compelled to deal through the bank.*" *Id.* at 145 (emphasis added).

The Court found that the bank managers had devised a plan or scheme to acquire, for themselves and others, UDC shares from Indians and were active in encouraging a market for the UDC stock among non-Indians. 406 U.S. at 152-153. They solicited and accepted standing orders from non-Indians and were entirely familiar with the prevailing market for the stock at all material times. *Id.* at 152. The managers received various commissions and gratuities for their services in facilitating the transfer of UDC stock from Indians to non-Indians. *Id.* Most im-

portantly for present purposes, the Court specifically found that the Indians "considered these defendants to be familiar with the market for the shares of stock and *relied upon them when they desired to sell their shares.*" *Id.* (emphasis added) (citation omitted).

In sum, the facts overwhelmingly demonstrated direct reliance by Indian stockholders on the conduct of the defendant bank and its managers, who had used their unique position with respect to the Indian plaintiffs' interest in the UDC stock to prey upon unsophisticated investors for the defendants' direct personal benefit. Yet the managers never told the Indians that there was another market for their UDC shares, in large part developed and encouraged by the defendants themselves, and that UDC shares sold for a higher price in that market than the Indians were receiving. 406 U.S. at 153. These were the circumstances that provided the basis for the Court's holding that, "[u]nder the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery." *Id.*

The primary cases cited by the Court in *Affiliated Ute* support the notion that the plaintiff must show *some* form of reliance on the defendant's conduct before reliance on omissions of particular facts may be presumed.[7] For example, the Court cited (406 U.S. at 154) *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970), for the proposition that a defendant's nondisclosure when under a duty to disclose demonstrates causation in fact. In *Chasins*, however, the court specifically noted that the plaintiff had relied on his securities broker's conduct. *Id.* at 1172.

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[7] The importance of reliance on defendants' conduct is also evidenced by the Court's discussion of *Affiliated Ute* in *Chiarella v. United States*, 445 U.S. 222, 230 (1980) (emphasis added): "The Court recognized that no duty of disclosure would exist if the bank merely had acted as a transfer agent. But the bank also had assumed a duty to act on behalf of the shareholders, *and the Indian sellers had relied upon its personnel when they sold their stock.*"

Similarly, in *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970), the defendant had sent proxy statements containing misleading omissions to its shareholders seeking their approval of a proposed merger. Thus, the issue was not whether the shareholders had received the document containing the misleading omissions—evidencing reliance on the conduct of the defendant—but whether the specific factual omissions in the proxy statement should be presumed to have influenced the voting process. *Id.* at 384-385. Under these circumstances, the Court held that the requisite causal nexus between the omission and the plaintiffs' injury was adequately established by proving that "the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction." *Id.* at 385. Again, the Court allowed plaintiffs to dispense with proof of reliance on factual omissions, but only in the face of evidence strongly indicating that it was logical to do so because the plaintiffs had received defendants' proxy solicitation.[8]

Properly understood, therefore, *Affiliated Ute* does not permit reliance on omissions of particular facts to be presumed unless the circumstances demonstrate that such a

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[8] In *Affiliated Ute*, the Court also cited an insider trading case, *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied, sub nom. Coates v. SEC*, 394 U.S. 976 (1969). As the Court has subsequently recognized, however, insider trading cases are conceptually distinct from cases where, as here, the defendant did not trade. In insider trading cases, the element of deception "derives from the 'inherent unfairness involved where one takes advantage' of 'information intended to be available only for a corporate purpose and not for the personal benefit of anyone.'" *Dirks v. SEC*, 463 U.S. 646, 654 (1983) (quoting *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 936 (1968)). The peculiar nature of the deception also serves to define the scope of liability for insider trading violations, which is typically limited to contemporaneous traders of the defendant and to the unlawful profits made by the defendant. *See, e.g., Wilson v. Comtech Telecommunications Corp.*, 648 F.2d 88, 94 (2d Cir. 1981)' (contemporaneous traders); *Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 172 (2d Cir. 1980) (disgorgement of unlawful profits).

presumption is rational because plaintiffs have relied on defendants' conduct. As discussed next, however, the courts of appeals have reached differing conclusions on this issue.

B. The Courts Of Appeals Have Not Agreed On Whether *Affiliated Ute* Authorizes A Presumption Of Reliance On Factual Omissions In The Absence Of Any Showing That Plaintiffs Relied On Anything That Defendants Said Or Did

The Seventh Circuit has recognized that *Affiliated Ute* was not intended to provide an excuse to "presume" reliance in the absence of any evidence indicating that it is logical to do so. Consequently, it has held specifically that plaintiffs are not entitled to invoke the *Affiliated Ute* presumption when they have not alleged that they read or relied on the document containing a defendant's omissions of material facts. In *Latigo Ventures v. Laventhol & Horwath*, 876 F.2d 1322, 1325 (7th Cir. 1989), a group of investors alleged that an accounting firm's audit report contained misleading omissions, but they did not "claim to have relied on the 1982 audit report or even to have read it." The court of appeals cogently identified the fundamental flaw in plaintiffs' allegations:

> Where misrepresentations are made but not relied on directly or indirectly (we are a about to turn to the indirect case [the fraud-on-the-market theory]), a plaintiff in a fraud case cannot show that he was harmed by them. When what is charged is not misrepresentation but omission, the word "reliance" is awkward and it is better to speak of the plaintiff's having been misled to his detriment. [citing *Affiliated Ute*] Although the plaintiffs in this case allege both misrepresentations and deceptive omissions by Laventhol & Horwath, they do not allege that these misrepresentations and deceptive omisisons misled or deceived *them*.

876 F.2d at 1326.[9]

[9] Similarly, in *Ross v. Bank South, N.A.*, 885 F.2d 723, 728 (11th Cir. 1989), *cert. denied*, 110 S. Ct. 1924 (1990), the Eleventh Cir-

As aptly stated by the Seventh Circuit, when plaintiffs have not alleged that they relied on any conduct of the defendant, the missing element of deception logically precludes application of the *Affiliated Ute* presumption of reliance. The court below, however, as well as the Second, Ninth, and Tenth Circuits, have not agreed with this analysis and have extended this Court's holding far beyond recognition. For example, the Second Circuit, in a case with remarkably similar facts to *Latigo Ventures*, reached an opposite result. In *Competitive Associates, Inc. v. Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811 (2d Cir. 1975), the court held that the plaintiff need not prove any actual reliance on the defendant's conduct. The district court had dismissed the action based on the admission of plaintiff's agent that he had never seen the financial statements audited by the defendant accounting firm. 516 F.2d at 813. The Second Circuit reversed, however, concluding that the plaintiff was entitled to a presumption of reliance under *Affiliated Ute. Id.* at 814. Rather gratuitously, the court of appeals held that "plaintiff should have the opportunity to prove, *but is not required to prove*, that it saw, or directly relied upon, the financial statements certified by the accounting defendants." *Id.* (emphasis added).

A few months later this type of analysis was adopted by the Ninth Circuit in *Blackie v. Barrack*, 524 F.2d 891, 905-906 (1975), *cert. denied*, 429 U.S. 816 (1976). Before enunciating its more well-known holding that plaintiffs were entitled to a presumption of reliance under the fraud-on-the-market theory, the court held that plaintiffs also were entitled to a presumption of reliance under *Affiliated Ute.* The court noted that the "class members' substantive claims either are, or can be, cast in omission

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cuit, after discussing when reliance may be presumed under *Affiliated Ute*, stated that "appellants concede that they did not read the offering documents and thus did not purchase the bonds in reliance on any material misrepresentations or omissions in those documents. In a traditional Rule 10b-5 case, that concession would be sufficient to justify dismissal." The court also dismissed plaintiffs' claims under a "fraud-created-the-market" theory. *Id.* at 730-731.

or non-disclosure terms—the company's financial reporting failed to disclose the need for reserves, conditions reflecting upon the value of the inventory, or other facts necessary to make the reported figures not misleading." *Id.* Under these circumstances, the court held that plaintiffs were not required to produce positive proof of reliance under *Affiliated Ute. See also Zweig v. Hearst Corp.*, 594 F.2d 1261, 1272 (9th Cir. 1979) (Ely, J., dissenting) (court granted the *Affiliated Ute* presumption despite "affirmative evidence of nonreliance"—plaintiffs had purchased their stock months before the defendant's misleading newspaper column was published). The Tenth Circuit adopted the approach of the Second and Ninth Circuits in *Cronin v. Midwestern Oklahoma Development Authority*, 619 F.2d 856, 859, 861, 862 (10th Cir. 1980) (presumption of reliance proper under *Affiliated Ute* even when plaintiff had not seen defendant's legal opinion and the district court had held that plaintiff did not rely on defendant's conduct).

These holdings, which dispense entirely with any allegation of reliance on the defendant's conduct, could not stand in starker contrast to this Court's holding in *Affiliated Ute.* From a case in which the circumstances overwhelmingly evidenced that plaintiffs had actually and directly relied on defendants in selling their stock, several circuits have managed to find authority for "presuming" reliance in the absence of any reason to believe that plaintiffs relied on *any* conduct of the defendant in making their investment decisions. As discussed next, there is no evidentiary reason for this distortion of the *Affiliated Ute* holding, and it directly conflicts with the intent of Congress when it enacted the express 1934 Act causes of action.

C. Policy Considerations Identified By This Court In Previous Section 10(b) Cases Strongly Support A Requirement That Plaintiffs Prove Some Reliance On A Defendant's Conduct As A Prerequisite To Recovery Of Damages

1. *Unlike Proof Of Reliance On Omissions Of Particular Facts, Proof Of Reliance On A Defendant's Conduct Does Not Impose An Unrealistic Evidentiary Burden On Section 10(b) Plaintiffs*

In *Basic*, 485 U.S. at 245, the Court explained that a presumption of reliance on factual omissions was granted in *Affiliated Ute* to avoid placing an "unnecessarily unrealistic evidentiary burden on the Rule 10b-5 plaintiff" to show a speculative state of facts—how the plaintiff would have acted if omitted information had been disclosed. *See also Sharp v. Coopers & Lybrand*, 649 F.2d 175, 188 (3d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982) ("The reason for shifting the burden on the reliance issue has been an assumption that the plaintiff is generally incapable of proving that he relied on a material omission."). Establishing some nexus between the parties by showing reliance on a defendant's conduct, however, does not require plaintiffs to show a speculative state of facts. Rather, plaintiffs can easily demonstrate such reliance if they can allege that they relied on any type of communication from the defendant, whether it be personal, written, audio, video or otherwise, in which the defendant failed to state a material fact. Under these circumstances, it is rational to presume reliance on the factual omission; understanding, of course, that the defendant is permitted to rebut the presumption by adducing affirmative proof of nonreliance. But if there is no communication whatsoever between plaintiffs and defendant, then reliance on defendant's conduct is not likely to be present, and there is no foundation on which to base a presumption that plaintiffs relied on defendant's omission of a particular fact.

For example, the plaintiffs in *Affiliated Ute* demonstrated reliance on defendants' conduct through their

personal contact with the defendants. Indeed, the Court specifically noted that the Indian plaintiffs were compelled to deal with the defendants when they desired to sell their stock. In cases involving alleged omissions in disclosure documents, plaintiffs need only allege that they read and relied on the documents. In this case, reliance on Arthur Young's conduct would not have been difficult to prove, if it had existed. The Class simply could have alleged that its members had heard Arthur Young's oral presentations at the annual meetings or read its audit reports and relied on them in purchasing demand notes. Proof of reliance on a defendant's conduct therefore poses no greater evidentiary problems for Section 10(b) plaintiffs than proof of reliance on affirmative misrepresentations. There is simply no evidentiary reason why an allegation of reliance on at least *some* aspect of a defendant's conduct should not be required in omissions cases.

2. *The Concepts Of Nondisclosure, Materiality, And Duty Are Not Adequate Substitutes For Reliance On A Defendant's Conduct In Defining The Scope Of Liability For Section 10(b) Violations*

Reliance plays a critical role in defining the scope of Section 10(b) liability. In *Basic*, in which the plaintiffs also could not allege that they directly relied on defendant's conduct, the Court required the plaintiffs to allege that they relied on something—an efficient market for their stock—before they were entitled to a presumption of reliance. 485 U.S. at 248 n.27. In the Eighth Circuit's view, however, plaintiffs can avoid having to allege *any* form of reliance simply by pleading the other elements of *Affiliated Ute*—nondisclosure, materiality, and duty. As discussed below, none of these other elements is an adequate substitute for reliance in defining the scope of Section 10(b) liability. Instead, they permit all purchasers or sellers of a given security, including those who purchased or sold for reasons completely unrelated to the defendant's disclosures, to recover their losses in a Section 10(b) action. Consequently, dispensing with proof of

reliance on a defendant's conduct "would effectively convert Rule 10b-5 into 'a scheme of investor's insurance,'" *Basic*, 485 U.S. at 252 (White, J., dissenting) (citation omitted), a result that finds no support in the federal securities laws.

a. *Nondisclosure.* Courts and commentators alike have noted the difficulty in distinguishing between cases involving primarily nondisclosure and cases involving primarily misrepresentation. *See, e.g., Wilson v. Comtech Telecommunications Corp.*, 648 F.2d 88, 93 (2d Cir. 1981); *Sharp v. Coopers & Lybrand*, 649 F.2d at 188; L. Loss, *Fundamentals of Securities Regulation* 1129 (1983) ("although the [*Affiliated Ute*] holding is limited to 'omissions' (nondisclosure) as distinct from 'misrepresentations,' the line between the two is fuzzy") (footnote omitted). The district court addressed this problem in a pre-trial opinion, noting that "every misrepresentation contains within itself the seeds of an omission" and "unless it is watched, the *Affiliated Ute* presumption will swallow all reliance requirements under Rule 10b-5." Pet. App. 215a.

In its post-trial opinion, however, the district court essentially threw up its hands and held that a case involves primarily nondisclosure "so long as any plausible case can be made for the following proposition: that if the plaintiff had known of a given fact, his decision would have been different." Pet. App. 285a-286a. Thus, instead of finding that Arthur Young *misrepresented* the proper carrying value of the Co-op, the district court found that Arthur Young *failed to disclose* the proper carrying value. The court of appeals simply accepted this characterization of the case, noting that "of great relevance in determining this issue is how a claimant pleads its Rule 10b-5 claim." Pet. App. 42a.

If plaintiffs can circumvent the reliance requirement merely by characterizing their cases as involving nondisclosures, little will be left of the requirement. Moreover, even when courts make their own characteriza-

tions, there is little consistency. *Compare Sharp*, 649 F.2d at 189 (in case involving both misrepresentations and omissions, court granted an *Affiliated Ute* presumption because defendant's "misrepresentation of other facts should not alleviate its burden of proving nonreliance") *with Wilson*, 648 F.2d at 93 (*Affiliated Ute* presumption available only when "no positive statements exist" and "reliance as a practical matter is impossible to prove"). In sum, the pliability of the concept of nondisclosure has made it an ineffective check on unwarranted expansion of the *Affiliated Ute* presumption.

b. *Materiality.* Materiality also is not an adequate substitute for reliance on a defendant's conduct. Rather, materiality is a much broader concept that produces a correspondingly much broader base of liability than reliance. Determining materiality—what information a reasonable investor would consider important in making an investment decision—is a theoretical exercise that is sure to encompass a great deal of information that would not necessarily induce an actual investment decision by any particular person. For example, even a document containing an omission of a material fact may also contain such negative information about a company that many potential purchasers would be dissuaded from investing. Proof that a plaintiff actually was aware of the defendant's disclosures and still purchased or sold, however, provides a concrete, factual link between defendant's conduct and plaintiff's decision to purchase or sell a security, and it thereby provides a much stronger basis on which to hold the defendant responsible for any loss that the plaintiff may have realized on the investment.

This case provides a clear example of the importance of reliance on a defendant's conduct in establishing a basis for liability. In view of the negative information that was disclosed concerning the Co-op's financial condition at the annual meetings, it may well be that no person who actually attended an annual meeting and heard Arthur Young's oral presentations subsequently purchased a demand note. For example, those who attended the

annual meeting in 1982 would have learned that the Co-op had acquired the gasohol plant, that it had lost $1.2 million the previous year, and that the Co-op had never previously lost more than $138,000 in a single year. Pet. App. 17a; C.A. Jt. App. 231. The atmosphere at the meeting became very heated when this information was revealed. Those who attended the annual meeting in 1983 would have learned that the Co-op lost another $1.2 million in 1982 and that its current liabilities were more than double its current assets. C.A. Jt. App. 261-263. It seems extremely unlikely that many attendees of the annual meetings would have considered the Co-op an attractive business in which to become a short-term creditor.

The point of this discussion of disclosures at the annual meetings is not to persuade that they were not misleading or to absolve Arthur Young from liability if any class members actually had been shown to have attended the meetings. Rather, the purpose is to illustrate that dispensing with proof of any affirmative reliance on the defendant's conduct can cause perverse results—plaintiffs can recover their investment losses from a defendant even though the losses likely would have been avoided if the plaintiffs in fact had relied on the defendant's conduct. This is exactly the type of investors' insurance that Congress did not intend to create when it enacted the 1934 Act.

c. *Duty.* Finally, duty, like nondisclosure and materiality, is not an adequate substitute for reliance in defining the scope of liability for Section 10(b) violations. Many securities markets participants, such as issuers and their officers and directors, owe duties to investors that are legally well established. Consequently, reliance could be "presumed" as to some defendants in nearly all Section 10(b) cases. Moreover, as evidenced by the Eighth Circuit's adoption of a "flexible duty" test in this case, the courts often are not shy about finding a "duty" in a wide variety of circumstances.[10]

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[10] The flexible duty test was applied by the Ninth Circuit in *Zweig v. Hearst Corp.*, 594 F.2d 1261, 1268-1269 (9th Cir. 1979),

Ironically, one of the seven factors that the court of appeals believed was most important in finding that Arthur Young owed a duty to the Class was awareness that demand note purchasers relied on Arthur Young in making their investment decisions. Pet. App. 46a. Consequently, in response to Arthur Young's argument that the record did not indicate that even one demand note purchaser had ever relied on anything Arthur Young said or did, the court of appeals granted a presumption of reliance in part because Arthur Young should have been aware that such purchasers were relying on it. The court of appeals thereby recognized the theoretical importance of reliance, but apparently believed that *theoretical* reliance was more important than *factual* reliance in defining the scope of Section 10(b) liability.

For present purposes, Arthur Young does not contest that those who read its audit reports or heard its oral presentations were entitled to a presumption of reliance, and it would not be petitioning this Court if the lower courts had imposed liability on this basis. No evidence, however, has been presented to indicate that any Class member cared about Arthur Young's opinion on the Co-op's financial condition prior to this lawsuit. Arthur Young submits that plaintiffs who were uninterested in what a defendant *did* say about a company before they decided to invest should not be entitled to a presumption of reliance on what the defendant did *not* say after they file an action under Section 10(b).

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to hold that the defendant newspaper columnist owed the requisite duty for an *Affiliated Ute* presumption to his readers, as well as the plaintiffs—two non-readers who had purchased their stock months before the defendant's column was published.

II. THE COURT OF APPEALS DISREGARDED ACCEPTED RULES OF APPELLATE PROCEDURE WHEN IT ADOPTED A THEORY OF LIABILITY UNDER THE ARKANSAS SECURITIES ACT THAT WAS NECESSARILY BASED ON FACTUAL FINDINGS NOT MADE BY THE DISTRICT COURT, NOT PRESENTED TO THE JURY, AND NOT OTHERWISE SUPPORTED BY THE RECORD

It is a general rule of appellate procedure that a federal appellate court does not consider factual issues that were not passed upon in lower court proceedings. *Singleton v. Wulff*, 428 U.S. 106, 120-21 (1976). As the Court has noted, this rule is "essential in order that parties may have the opportunity to offer all the evidence they believe relevant to the issues which the trial tribunal is alone competent to decide; it is equally essential in order that litigants may not be surprised on appeal by final decision there of issues upon which they have had no opportunity to introduce evidence." *Hormel v. Helvering*, 312 U.S. 552, 556 (1941); *see also SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943) ("where the correctness of the lower court's decision depends upon a determination of the fact which only a jury could make but which has not been made, the appellate court cannot take the place of a jury").

In this case, the court of appeals rejected the district court's common law theories for holding Arthur Young liable under the Arkansas Securities Act ("Act"), but nevertheless affirmed the district court's judgment by adopting a theory of aiding and abetting liability that necessarily was based on factual issues not passed upon by the district court, not presented to the jury, and not otherwise supported by the record. Arthur Young therefore was quite "surprised"—and unfairly so—by the Eighth Circuit's decision. While this Court has recognized exceptions to the general appellate rule where "the proper resolution is beyond any doubt," or where "injustice might otherwise result," *Singleton*, 428 U.S. at 121 (citations omitted), these exceptions are not applicable in this case.

The relevant provisions of the Act, which were derived from Section 410 of the Uniform Securities Act, 7B U.L.A. 643 (1956) (superseded 1985), impose primary liability on sellers of securities for sales made by means of misleading disclosures. Ark. Stat. Ann. § 23-42-106(a)(1)(B). In addition, the Act imposes two types of secondary liability on specifically enumerated classes of persons. Ark. Stat. Ann. § 23-42-106(c). Control person liability is based solely on a person's "status" as a partner, officer, or director of a seller, a person performing a similar function, or any other person who controls a seller. Aiding and abetting liability is imposed only on an "employee" of the seller, "broker-dealer," or "agent" who materially aids in a sale that violates the Act.[11]

The district court repeatedly indicated that Arthur Young did not fall within any of the statutorily enumerated categories of persons having secondary liability, but decided that statutory liability could be implicated under the Act against all those who would be liable as joint tortfeasors at common law. *See, e.g.*, Pet. App. 268a ("surely there can be no impediment in the language of the statute to an implication of liability against one not named as liable by the Act"); Pet. App. 211a (statutory enumeration of parties with secondary liability not "meant to supplant the common law, by exculpating those parties who otherwise would be liable as joint tortfeasors"). The court of appeals properly rejected the district court's attempt to rewrite the statute, but found that Arthur Young was still liable under the Act because "the jury could have held Arthur Young liable only if it concluded that the firm materially aided in the sale of demand notes." Pet. App. 37a.

This conclusion alone, however, was not sufficient to impose aiding and abetting liability on Arthur Young, be-

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[11] The Arkansas statute should be contrasted with other state securities statutes derived from the Uniform Securities Act that have been amended specifically to impose secondary liability on *any* person who materially aids in a sale. *See, e.g.*, Okla. Stat. Ann. tit. 71, § 408(b) (West Supp. 1992); Or. Rev. Stat. § 59.115(3) (1989).

cause such liability is imposed only on "employees," "broker-dealers" and "agents"—a critical statutory requirement that has been emphasized by the Supreme Court of Arkansas. *See Hogg v. Jerry*, 773 S.W.2d 84, 89 (Ark. 1989) ("appellees argue that [defendant] materially aided in the sale of each investment, yet [defendant] meets neither the statutory definition of an employee, an agent, or a broker-dealer"). The district court did not find that Arthur Young fell within any of these statutory categories. Indeed, it was for this very reason that the district court engrafted common law theories of joint tortfeasor liability onto the Act. Consequently, the issue of whether Arthur Young was an "employee," "broker-dealer," or "agent" was not presented to the jury.

The court of appeals did not make an explicit finding, but the only conceivable category in which Arthur Young might fall is that of an employee of the Co-op.[12] "Employee" is not defined in the Act, but the governing test under Arkansas common law is "whether the asserted employer had the right to control" the alleged employee in its work. *Sandy v. Salter*, 541 S.W.2d 929, 931 (Ark. 1976); *see also Martin v. Pepsi-Cola Bottling Co.*, 639 F. Supp. 931, 935 (D. Md. 1986) (independent contractor not an employee under Maryland version of

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[12] Arthur Young does not even arguably fall within the other two categories. "Broker-dealer" is statutorily defined as "any person engaged in the business of effecting transactions in securities for the account of others or for his own account." Ark. Stat. Ann. § 23-42-102(3). "Agent" is statutorily defined as an individual "who represents a broker-dealer or issuer in effecting or attempting to effect purchases or sales of securities." Ark. Stat. Ann. § 23-42-102(2). This category therefore is more aptly labeled as "selling agent," and, like broker-dealers, selling agents must register with the Arkansas Securities Commissioner. *See Jenson v. Touche Ross & Co.*, 335 N.W.2d 720, 729 (Minn. 1983) (under Minnesota version of Uniform Securities Act, auditor could not be considered statutory agent of seller). Arthur Young neither falls within either of these categories nor ever had reason to litigate the factual issues necessary to a finding that it fell within either of these categories.

Uniform Securities Act); *Allen v. Columbia Financial Management*, 377 S.E.2d 352, 356 (S.C. Ct. App. 1988) (under South Carolina version of Uniform Securities Act, attorney was held not to be an employee of the seller).

Arthur Young clearly was not under the control of the Co-op. Indeed, the Class alleged just the opposite state of affairs in the proceedings below—that Arthur Young controlled the financial reporting of the Co-op and therefore either controlled the Co-op or performed a function similar to that of chief financial officer of the Co-op. *See, e.g.*, Appellees' Supplemental Brief on Remand at 12-13. Even these factual allegations were rejected by the court of appeals in the context of evaluating the Class' RICO claims. The court found that Arthur Young's involvement with the Co-op "in no way rise[s] to the level of participation in the management or operation of the Co-op." Pet. App. 30a. In sum, the court of appeals' theory of liability necessarily was based on factual findings not made by the district court, not presented to the jury, and not otherwise supported by the record.

We recognize that the Court generally does not grant certiorari to decide state law issues,[13] and the determination of whether an issue should be considered on appeal is left primarily to the discretion of the courts of appeals. *Singleton*, 428 U.S. at 121. Nevertheless, the court of appeals' action in this case sufficiently departed from accepted rules of appellate procedure that it im-

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[13] Because the relevant provisions of the Act were derived from the Uniform Securities Act, which has been adopted in 33 states, 7B U.L.A. 124 (1991 Supp.), the Eighth Circuit's interpretation of an auditor's aiding and abetting liability could have broader ramifications than would normally be the case. State securities law issues tend to be litigated quite frequently in federal courts because claims under state securities laws are often brought in conjunction with claims under the federal securities laws. Our review of the annotations to the Uniform Securities Act has not revealed any other case in which an auditor was found to have aiding and abetting liability as an employee, broker-dealer, or agent.

plicates the supervisory responsibility of this Court to ensure that the courts of appeals properly perform their judicial function. Because of the peculiar nature of the issue presented by this case, liability has been imposed on Arthur Young based on a legal theory that Arthur Young has not had reason to contest in *any* forum. Consequently, the Court should grant this petition in order to reverse the Eighth Circuit's judgment because it was based on a legal theory not supported by the record after a month-long jury trial. Alternatively, the Court could remand for further proceedings necessary to resolve the factual issues underlying the Eighth Circuit's theory of liability.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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